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APPLICATION OF AEP TEXAS INC. § BEFORE THE STATE OFFICE
FOR AUTHORITY TO CHANGE §
RATES § OF
§
§ ADMINISTRATIVE HEARINGS
§

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- The ALJs do not recommend disallowing any costs related to numerous refurbished or new service centers, including a new transmission operations facility.

Rate of Return

- The ALJs recommend a return on equity (ROE) of 9.40%; a cost of debt of 4.28%; a capital structure comprised of 55% long-term debt and 45% equity; and an overall rate of return of 6.58%.

Financial Integrity (Ring-Fencing Protections)

- The ALJs conclude that the Commission has authority to order AEP Texas to employ the ring-fencing measures recommended in the PFD, and the evidence supports ordering all or portions of six ring-fencing measures proposed by Staff, in addition to the four ring-fencing measures already employed by the Company.

Operations and Maintenance (O&M) Expenses

- The ALJs recommend reducing AEP Texas's transmission and distribution O&M expense by \$9.689 million.
- The ALJs recommend disallowing the Company's proposed \$5 million increase for distribution vegetation management, but the ALJs also recommend a \$4.01 million *pro forma* increase to vegetation management O&M expense to account for the reclassification of test year capitalized vegetation management costs to expense.
- The ALJs recommend removing \$167,398 in carrying charges received by AEP Texas from its affiliates, and removing \$12,511 from Miscellaneous General Expense.
- Regarding incentive compensation expense, the ALJs recommend removing:
 - 100% of financially based incentive compensation and 70% of operationally based incentive compensation to account for the funding mechanism.
 - \$2,250,430 attributable to financially based long-term incentive compensation.

since then. The Commission has changed the capital structures awarded to similarly situated utilities, moving toward the capital structure advocated by AEP Texas. The ALJs are persuaded that moving to a 55/45 capital structure will enhance the credit metrics and assist AEP Texas in securing needed financing at reasonable costs. Finally, the fact that AEP Texas has been managing to operate under an actual structure of 55% debt and 45% equity argues favorably towards adoption of that capital structure for regulatory purposes. Therefore, the ALJs recommend adoption of a capital structure composed of 55% debt and 45% equity.

D. Overall Rate of Return [PO Issue 12]

The overall rate of return is a product of the capital structure, ROE, and cost of debt. Based on the discussion set forth above, the ALJs recommend that the Commission adopt the following overall rate of return for AEP Texas:

Component	Cost	Weighting	Weighted Cost
Debt	4.28%	55%	2.35%
Equity	9.40%	45%	4.23%
Overall			6.58%

E. Financial Integrity, Including “Ring-Fencing” [PO Issue 13]

Issue 13 in the Commission’s Preliminary Order asks: “Are any protections, such as financial protections, appropriate to protect the utility’s financial integrity and ability to provide reliable service at just and reasonable rates?” These types of financial protections are commonly referred to as “ring-fencing.”⁶⁷⁵ Staff, with the support of TIEC, presented a number of ring-fencing proposals. AEP Texas opposes ring fencing, arguing that the Commission lacks authority

⁶⁷⁵ The phrase “ring-fencing,” in a regulatory context, “refers to the general concept of establishing various requirements or policies that effectively isolate and thereby insulate a regulated entity from the effects of a parent organization’s financial distress and, in a worst-case scenario, bankruptcy.” Staff Ex. 1 (Tietjen Dir.) at 8.

in this rate case to order ring-fencing, and the proposals are unnecessary in AEP Texas's case.⁶⁷⁶ The ALJs recommend that the Commission adopt some but not all of the ring-fencing proposals.

1. Background and the Parties' Arguments

Staff recommends that the Commission require AEP Texas to implement 17 financial protections to financially insulate the Company from its parent company, AEP, and AEP Texas's other subsidiaries.⁶⁷⁷ Four of the 17 recommended financial protections, or measures, are already employed by AEP and AEP Texas. The 17 recommended measures are:⁶⁷⁸

Financial Protections Currently Employed by AEP:

- AEP Texas must not share its credit facility with any unregulated affiliates;
- AEP Texas debt must not be secured by non-AEP Texas assets;
- AEP Texas assets must not secure the debt of AEP or its non-AEP Texas affiliates; and
- AEP Texas assets must not be pledged for any other entity.

Additional Financial Protections Proposed by Staff:

- Dividend Restriction Commitment. AEP Texas must limit the payment of dividends by AEP Texas to an amount not to exceed AEP Texas's net income (as determined in accordance with [GAAP]).
- AEP Credit Ratings and Dividends. AEP Texas must work to ensure that its credit ratings at S&P and Fitch remain at or above AEP Texas's current credit ratings, and if AEP Texas's credit rating at either of these ratings agencies falls

⁶⁷⁶ The ALJs note that the positions taken in this case by Staff and TIEC are very similar, if not identical, to the ring-fencing positions they took in the CenterPoint base rate case proceeding currently pending before the Commission: *CenterPoint Energy Houston Electric, LLC for Authority to Change Rates*, Docket No. 49421, PFD (Sep. 16, 2019).

⁶⁷⁷ Staff Initial Brief at 28-33.

⁶⁷⁸ Staff Ex. 1 (Tietjen Dir.) at 15-18.

below BBB+⁶⁷⁹ (or its equivalent) for AEP Texas's senior secured debt, then AEP Texas must suspend payment of dividends or other distributions, except for contractual tax payments, until otherwise allowed by the Commission. AEP Texas must notify the Commission if its credit issuer rating or corporate rating as rated by either of the major rating agencies falls below investment-grade level.

- Debt-to-Equity Ratio Commitment. AEP Texas's debt must be limited so that its debt-to-equity ratio is at or below the debt-to-equity ratio established from time to time by the Commission for ratemaking purposes in AEP Texas's rate proceedings. The Commission has authority to determine what types of debt and equity are included in a utility's debt-to-equity ratio. AEP Texas must not make any payment of dividends or other distributions, except for contractual tax payments, where such dividends or other distributions would cause AEP Texas to be out of compliance with the Commission-approved debt-to-equity ratio. Additionally, neither AEP nor any of its affiliates may issue stock or ownership interest that supersede the foregoing obligations of AEP Texas.
- ROE Commitment. If AEP Texas's issuer credit rating is not maintained as investment grade by S&P and Moody's, AEP Texas must not use its below-investment-grade ratings to justify an argument in favor of a higher regulatory ROE.
- Stand-Alone Credit Rating. Except as may be otherwise ordered by the Commission, AEP Texas must take the actions necessary to ensure the existence of a AEP Texas stand-alone credit rating.
- AEP Texas's Credit. AEP Texas must not hold out its credit as being available to pay the debt of any AEP affiliates.
- No Commingling of Assets. AEP Texas must not commingle its assets with those of other AEP affiliates.
- No Pledging of Assets Commitment. AEP Texas must not pledge its assets with respect to, or guarantee, any debt or obligation of AEP affiliates.
- Affiliate Asset Transfer Commitment. AEP Texas must not transfer any material assets or facilities to any affiliates, other than a transfer that is on an arm's-length basis consistent with the Commission's affiliate standards applicable to AEP Texas, regardless of whether such affiliate standards would apply to the particular transaction.

⁶⁷⁹ *Id.* at 17 ("This rating is two notches above the minimum investment-grade rating. The Commission may conclude a higher rating is appropriate for this threshold.").

- No Inter-Company Lending and Borrowing Commitment. AEP Texas must not lend money to or borrow money from AEP affiliates.
- No Debt Disproportionally Dependent on AEP Texas. Without prior approval of the Commission, neither AEP nor any affiliate of AEP (excluding AEP Texas) may incur, guaranty, or pledge assets in respect of any incremental new debt that is dependent on: (1) the revenues of AEP Texas in more than a proportionate degree than the other revenues of AEP; or (2) the stock of AEP Texas.
- Non-Consolidation Legal Opinion. AEP must obtain a non-consolidation legal opinion that provides that, in the event of a bankruptcy of AEP or any of its affiliates, a bankruptcy court will not consolidate the assets and liabilities of AEP Texas with AEP or any of its affiliates.
- No Bankruptcy Cost Commitment. AEP Texas must not seek to recover any costs associated with a bankruptcy of AEP or any of its affiliates.

Staff predicates its recommendation by noting that AEP, with \$69 billion of assets, is a large corporation that includes not only AEP Texas as a subsidiary, but also several other entities.⁶⁸⁰ Staff contends that the effects of financial instability or weakness in one entity could affect not only AEP as the parent company, but other subsidiaries as well.⁶⁸¹ In an extreme case, an event that causes severe financial distress for AEP “could lead to its bankruptcy—a situation that, absent the presence of protective measures, could impact subsidiaries like AEP Texas dramatically and drag them along into the bankruptcy process.”⁶⁸²

Staff witness Tietjen states that rating agencies have recognized the lack of financial protections between AEP Texas and AEP. For example, S&P stated in its March 26, 2019 “Group Influence” assessment regarding AEP that “[t]here are no meaningful insulation measures that protect AEP Texas from AEP.”⁶⁸³ S&P also commented that it “could also lower the ratings [on AEP and its subsidiaries] if the company’s business risk increases because of ineffective

⁶⁸⁰ Staff Ex. 1 (Tietjen Dir.) at 6.

⁶⁸¹ *Id.* at 6-7.

⁶⁸² Staff Initial Brief at 30, citing Staff Ex. 1 (Tietjen Dir.) at 7.

⁶⁸³ Staff Ex. 1 (Tietjen Dir.) at 14.

management of regulatory risk or the pursuit of risky unregulated investments.”⁶⁸⁴ Mr. Tietjen testified that ratings actions and commentary from major credit rating agencies take into account how transactions, business operations, and leveraging activities of a parent company and its subsidiaries can have wide-ranging effects, not only on the credit profile and financial exposure of the parent, but also on regulated utility affiliates.⁶⁸⁵ This, in turn, can affect certain of the regulated utility’s rate-related elements such as capital structure and cost of capital (both equity costs and debt costs).⁶⁸⁶ If these circumstances lead to a higher cost of providing service for the regulated utility, Staff anticipates that “it is possible—or likely—that the utility in its next rate proceeding will request that ratepayers bear the higher costs.”⁶⁸⁷ Staff contends that pre-emptive Commission actions, such as requiring the utility to implement protective ring-fencing mechanisms, are within the Commission’s responsibility and authority to insulate a regulated utility from the financial weakness of its parent or affiliates.⁶⁸⁸

Staff concedes, however, that AEP’s existing corporate structure and general operating and financial profile—of which AEP Texas is a part—“may not be as likely as that of the parents of some other Texas utility companies to experience financial stress that could flow through to its subsidiaries.”⁶⁸⁹ Mr. Tietjen also stated that a regulatory agency’s use of financial protection measures may differ for different companies depending on the specific circumstances that apply in a case.⁶⁹⁰ Nonetheless, Staff suggests that application of a relatively standardized set of

⁶⁸⁴ *Id.*

⁶⁸⁵ *Id.*

⁶⁸⁶ *Id.*

⁶⁸⁷ Staff Initial Brief at 30, citing Staff Ex. 1 (Tietjen Dir.) at 14-15.

⁶⁸⁸ PURA §§ 11.002, 14.001; *see also* Staff Ex. 1 (Tietjen Dir.) at 12.

⁶⁸⁹ Staff Initial Brief at 31, citing Staff Ex. 1 (Tietjen Dir.) at 16. *See also* Staff Reply Brief at 28 (“AEP Texas may be correct that the risks of its parent or affiliate detrimentally impacting the financial well-being of AEP Texas may be remote, but the Commission’s duty to utilities and customers is to ensure the financial integrity of the utility while ensuring just and reasonable rates to consumers.”).

⁶⁹⁰ Staff Ex. 1 (Tietjen Dir.) at 16.

ring-fencing provisions to all Texas investor-owned utility companies may be a prudent regulatory policy..⁶⁹¹

Staff argues that a number of provisions in PURA provide the Commission with authority to implement ring-fencing measures. First, the proposed financial protections are necessary to preserve the financial integrity of the utility under PURA § 36.051, which provides:

In establishing an electric utility's *rates*, the regulatory authority shall establish the utility's overall revenues at an amount that will permit the utility a reasonable opportunity to earn a reasonable return on the utility's invested capital used and useful in providing service to the public in excess of the utility's reasonable and necessary operating expenses..⁶⁹²

The term "rate" is defined in PURA to include "a rule, practice, or contract affecting the compensation, tariff, charge, fare, toll, rental, or classification that must be approved by a regulatory authority.."..⁶⁹³ Staff states that the risks imposed by AEP and its other subsidiaries on AEP Texas may affect the Company's ability to attract capital on reasonable terms..⁶⁹⁴ According to Staff, this means that it is within the Commission's jurisdiction to establish financial protections to be followed by AEP Texas to insulate the regulated utility from its unregulated parent and affiliates..⁶⁹⁵

Second, two other provisions in PURA provide the Commission with authority to require the financial protections: PURA §§ 11.002 (Purpose and Findings) and 14.001 (Power to Regulate and Supervise)..⁶⁹⁶ PURA § 11.002 provides in subsections (a) and (b) that:

⁶⁹¹ Staff Initial Brief at 31.

⁶⁹² PURA § 36.051 (emphasis added).

⁶⁹³ PURA § 31.002.

⁶⁹⁴ Staff Exhibit 1 (Tietjen Dir.) at 14.

⁶⁹⁵ Staff Reply Brief at 30.

⁶⁹⁶ Staff Reply Brief at 30-31.

- (a) This title is enacted to protect the public interest inherent in the rates and services of public utilities. The purpose of this title is to establish a comprehensive and adequate regulatory system for public utilities to assure rates, operations, and services that are just and reasonable to the consumers and to the utilities.
- (b) Public utilities traditionally are by definition monopolies in the areas they serve. As a result, the normal forces of competition that regulate prices in a free enterprise society do not operate. Public agencies regulate utility rates, operations, and services as a substitute for competition..⁶⁹⁷

PURA § 14.001 states that:

The commission has the general power to *regulate and supervise* the business of each public utility within its jurisdiction and to do anything specifically designated or implied by this title that is necessary and convenient to the exercise of that power and jurisdiction..⁶⁹⁸

Staff concludes that the foregoing statutory provisions establish the Commission's broad authority over the rates, operations, and services of the public utilities it regulates, which in turn allows the Commission to establish protective measures that help ensure a utility's financial integrity and that facilitate the utility's ability to provide reliable service at just and reasonable rates.

TIEC supports Staff's proposed ring-fencing measures, emphasizing that it would be prudent to put reasonable financial protections in place before they become necessary, and a relatively standardized set of ring-fencing provisions should be adopted for all Texas investor-owned utilities, "though the exact mix of financial protections will vary by company."⁶⁹⁹ TIEC agrees with Staff that PURA provides the Commission with authority to order ring-fencing measures. Like Staff, TIEC cites to PURA §§ 11.002 and 31.001(a), which establish a

⁶⁹⁷ PURA § 11.002.

⁶⁹⁸ PURA § 14.001 (emphasis added).

⁶⁹⁹ TIEC Initial Brief at 44-45 (emphasis in original); TIEC Ex. 3 (Gorman Dir.) at 31-32.

“comprehensive and adequate regulatory system” over the rates, operations, and services of electric utilities..⁷⁰⁰ Consistent with the broad purpose of a comprehensive regulatory system, PURA § 14.001 gives the Commission the “general power to *regulate and supervise the business* of each public utility within its jurisdiction and to do *anything specifically designated or implied* ... that is necessary and convenient to the exercise of that power and jurisdiction.”⁷⁰¹ TIEC concludes that these general powers to regulate and supervise a utility’s business apply regardless of the type of proceeding a utility files, and are not diminished in the context of a Chapter 36 rate case.

AEP Texas raises numerous counter-arguments in response to Staff’s recommended ring-fencing measures. First, the Company states that the additional financial protections are not necessary, arguing that Staff offered no evidence that any of the measures are actually needed in AEP Texas’s case, and Staff recognized that AEP’s corporate structure and operations do not raise the sorts of issues where ring-fencing has historically been applied..⁷⁰² Moreover, Staff’s witness suggested that it would be reasonable for the Commission to distinguish between utilities within its jurisdiction in connection with the implementation of ring-fencing measures and acknowledged that AEP’s corporate structure and activities were less likely than those of other electric utilities to require ring-fencing measures..⁷⁰³ Similarly, while TIEC’s witness references ring fencing in passing in his direct testimony, AEP Texas states that he offers no explanation of which financial protection measures TIEC supports or why the measures might be necessary in the Company’s case..⁷⁰⁴

Second, AEP Texas argues that the costs and adverse effects of the additional measures outweigh any benefits. For example, if additional measures were imposed, the significant financial

⁷⁰⁰ TIEC Reply Brief at 33-34.

⁷⁰¹ TIEC Reply Brief at 33 (emphasis added by TIEC).

⁷⁰² AEP Texas Initial Brief at 68, citing Staff Ex. 1 (Tietjen Dir.) at 16.

⁷⁰³ Staff Ex. 1 (Tietjen Dir.) at 16; Tr. at 222-24.

⁷⁰⁴ AEP Texas Initial Brief at 68, citing TIEC Ex. 3 (Gorman Dir.) at 31.

benefits that AEP's current corporate structure affords AEP Texas and its customers would be lost and significant costs would be incurred, which would be detrimental not only to the Company, but also to its customers..⁷⁰⁵ The first three financial protections in Staff's proposal could choke off equity contributions from AEP to AEP Texas: "Any parent organization would be less likely to make equity contributions at a critical juncture if its ability to receive dividends when the funds are no longer needed from an operational standpoint is jeopardized."⁷⁰⁶ AEP Texas contends that the proposed financial protection measures would interfere with its ability to efficiently access capital markets. The Company anticipates that if its debt to equity ratio cannot fall below a specified level under the ring-fencing measures, it would be required to maintain excess, or stranded, equity in its capital structure as a precaution, which would likely leave AEP Texas short of critical capital at inopportune times..⁷⁰⁷

AEP Texas argues that imposition of the Staff's proposed ring-fencing measures would effectively isolate AEP Texas and make it difficult, if not impossible, for AEP to step in to provide additional funding in the event that AEP Texas suffered from any financial difficulty. For example, restrictions on commingling assets would likely result in the loss of the benefits of the Company's participation in AEP's Utility Money Pool. AEP Texas lists a number of unknowns, and potentially adverse and expensive effects, if the Company were required to obtain a non-consolidation legal opinion as proposed by Staff:

For instance, what does it mean that AEP will not commingle its assets? Does that effect physical locations, joint servicing agreements, or an advance to the Utility Money Pool? The Non-Consolidation Legal Opinion may require any number of operational and shared service changes and be prohibitively expensive to obtain. AEP Texas has been managed as part of a holding company for decades and all affiliate agreements would have to be reviewed as part of obtaining a Non-

⁷⁰⁵ AEP Texas Initial Brief at 68; AEP Reply Brief at 79 ("Nowhere in the Staff's brief is there a discussion of the benefits that would be lost, the costs that would be imposed, or whether, in AEP Texas's case, it would be worthwhile to impose any additional measures, given that none of the risks the measures are designed to protect against are present.").

⁷⁰⁶ AEP Texas Reply Brief at 77, citing AEP Texas Ex. 43 (Hawkins Reb.) at 13-14.

⁷⁰⁷ AEP Texas Initial Brief at 77-78, citing AEP Texas Ex. 43 (Hawkins Reb.) at 14.

Consolidation Legal Opinion. These restrictions will have numerous consequences and costs that are not known at this time..⁷⁰⁸

AEP Texas describes the additional costs that would be incurred if Staff's proposed measures were imposed as "significant," and these costs would be borne by the Company's customers..⁷⁰⁹ The Company argues that these significant costs are not justified by meager benefits: "given that the risk of affiliate bankruptcy that the measures would be designed to protect is remote, any sort of cost/benefit analysis would argue in favor of not imposing any of the measures in this case.." ⁷¹⁰

Responding to Staff's statements regarding the ratings agencies, AEP Texas states that in the cited portion of the S&P report, S&P is merely explaining its rating protocol: "it is stating a fact, not issuing a warning.." ⁷¹¹ The Company contends that S&P is not making a value judgment one way or the other regarding AEP Texas's relationship with its parent, rather S&P employs a group methodology when making individual rating decisions that considers the risks and operations of the consolidated group. ⁷¹²

The Company recounts that ring-fencing has been imposed in Texas when the regulated utility faces an acquisition involving an acquirer with significant amounts of debt and/or risky unregulated activities, or in a situation involving the issuance of securitization bonds..⁷¹³ AEP Texas states that it and AEP, with their corporate structure and operations, raise none of the risks associated with the need for ring-fencing, and Staff's witness acknowledged that there was not currently a danger of excess parent level debt or a concern over excess levels of unregulated

⁷⁰⁸ AEP Texas Ex. 43 (Hawkins Reb.) at 18. Mr. Tietjen acknowledged that there would be certain costs associated with the legal opinion's issuance. Tr. at 225-26. *See also* AEP Texas Initial Brief at 72.

⁷⁰⁹ AEP Texas Ex. 44 (Fetter Reb.) at 13-14; AEP Texas Ex. 43 (Hawkins Reb.) at 17.

⁷¹⁰ AEP Texas Initial Brief at 72.

⁷¹¹ AEP Texas Initial Brief at 78.

⁷¹² AEP Texas Ex. 7 (Hawkins Dir.) at 8.

⁷¹³ AEP Texas Ex. 44 (Fetter Reb.) at 8, 13.

activity..⁷¹⁴ Moreover, the Company explains that the Commission's affiliate rules have protected and benefited the Company's customers with, for example, a \$300 million equity layer that AEP has effectively contributed to the Company in the last four years by both: (1) injecting capital of \$653 million into the Company; and (2) foregoing dividend payments since 2016..⁷¹⁵ AEP Texas states that any additional ring-fencing measures could jeopardize these, and these types, of benefits. As an example of a negative consequence, AEP Texas is concerned that AEP will be less likely to inject additional funding into the Company if the Commission limits the ability of AEP Texas to pay dividends..⁷¹⁶

AEP Texas witness Fetter has supported ring-fencing measures in the past when they were warranted—*i.e.*, when the utility's parent was highly leveraged or had significant amounts of risky unregulated activities..⁷¹⁷ For example, Mr. Fetter testified in favor of the implementation of ring-fencing measures in several Oncor Electric Delivery Company LLC (Oncor) proceedings..⁷¹⁸ However, he is not supportive of the measures in this case..⁷¹⁹ Mr. Fetter also explained that a utility's access to necessary capital (including financial assistance from a parent) can be critical in times of financial difficulty, and he provided examples of the importance of this access. For example, in illustrating the importance of strong utility credit ratings, Mr. Fetter pointed to the situation involving the 'BBB' category-rated Entergy New Orleans after Hurricane Katrina, which led to its bankruptcy and operational difficulties until support came from its parent, Entergy Corporation..⁷²⁰

⁷¹⁴ Staff Ex. 1 (Tietjen Dir.) at 17; Tr. at 222-24.

⁷¹⁵ AEP Texas Initial Brief at 70, citing AEP Texas Ex. 43 (Hawkins Reb.) at 12-13.

⁷¹⁶ AEP Texas Ex. 43 (Hawkins Reb.) at 13-14.

⁷¹⁷ AEP Texas Ex. 44 (Fetter Reb.) at 6-8; Tr. at 691-92.

⁷¹⁸ AEP Texas Ex. 44 (Fetter Reb.) at 7; Tr. at 691.

⁷¹⁹ AEP Texas Ex. 44 (Fetter Reb.) at 8-15; Tr. at 691-92.

⁷²⁰ AEP Texas Ex. 44 (Fetter Reb.) at 3.

Mr. Fetter expressed a strong opinion regarding the role of a regulatory commission:

As Chairman of the Michigan Commission, I never wanted to dictate what actions utility management had to take, lest how could I sit in judgment regarding managerial prudence when the regulators had directed what they had to do. But, nevertheless, right there in black and white is, “The Commission has authority to determine what types of debt and equity are included in a utility’s debt-to equity ratio.” [Referring to language in the “Debt-to-Equity Ratio Commitment” in the list of Staff’s proposed financial measures.] Not approve what the Company proposes, mind you, but the Commission will determine what types of debt and equity will go into a regulated utility’s capital structure. I never thought I would see the day when a public utilities commission (and its members) might set itself up to potentially become a defendant in a shareholder lawsuit.⁷²¹

AEP Texas witness Hawkins also presented extensive rebuttal testimony that addressed the extra costs and burdens that could be placed on the Company with the additional financial protections, while also explaining that additional protections are not necessary. Ms. Hawkins focused primarily on three categories of proposed ring-fencing measures: dividends, intra-company lending, and the Non-Consolidation Legal Opinion.

Ms. Hawkins testified that the proposed financial protections that would affect dividends are not necessary because:

The Company has a long history of making reasonable and reasoned dividend decisions for the benefit of AEP Texas and its customers. With no prompting from the Commission, AEP Texas has not paid a dividend since 2016 in order to support the capital program and credit ratings. The Company has been an exceptional steward of the credit ratings and capital for the benefit of AEP Texas customers. Placing unnecessary dividend restrictions on AEP Texas at this time disregards that history.⁷²²

Ms. Hawkins explained that the Company can make dividend and equity contribution recommendations with the understanding that capital can be returned to AEP as a dividend when

⁷²¹ AEP Texas Ex. 44 (Fetter Reb.) at 12-13.

⁷²² AEP Texas Ex. 43 (Hawkins Reb.) at 12.

cash flows are available to support a dividend. She stated that Commission-imposed dividend restrictions would increase risk for AEP and may deter future equity contributions. Further, if the Company's debt-to-equity ratio cannot fall below the suggested ratio, AEP Texas would be required to have excess, or stranded, equity in the capital structure just in case, and this is equity on which the Company would not earn a return. She testified that if there is positive free cash flow available, or if the Company has excess equity in the capital structure, it should be allowed to dividend above net income to maintain an appropriate capital structure..⁷²³

Ms. Hawkins next explained the corporate intra-AEP borrowing program—the Utility Money Pool—for regulated utilities within AEP. She testified that the benefits of the Utility Money Pool include: (1) allowing each participant to minimize the cost of its short-term borrowings and maximize the returns from its short-term investments; (2) providing the ability of AEP to pool funds and maintain shared credit lines for its subsidiaries, which results in more efficient funding and lower borrowing rates; and (3) providing the ability to pool investment funds, which results in the maximum amount being invested at more favorable investment rates.

Ms. Hawkins testified that the Utility Money Pool also benefits the participants in several ways as compared to each subsidiary managing its short-term funding requirements independently. First, each subsidiary does not have to obtain and maintain a short-term credit rating, obtained at significant cost, from a rating agency, as would be required if that subsidiary were to operate a separate money pool and use it to issue commercial paper. Second, to issue commercial paper, each subsidiary would need to obtain its own credit facility to act as a “backstop” for the issuance, “but the Utility Money Pool allows the participants to use the AEP credit facility as the backstop, thereby eliminating the upfront and ongoing costs associated with obtaining a separate credit facility.” Third, the system-wide approach reduces overhead costs to the participants because they benefit from the economies of scale associated with the program. Fourth, the Utility Money Pool is used to fund inter-company transactions, thereby reducing bank charges and minimizing the amount of cash required to be on hand. Fifth, the Utility Money Pool provides a further benefit

⁷²³ AEP Texas Ex. 43 (Hawkins Reb.) at 13-14.

by allowing AEP Texas to invest any available funds on a daily basis and earn better rates. Ms. Hawkins testified that, without the Utility Money Pool, AEP Texas would have to invest funds externally. And a minimum investment amount might preclude AEP Texas from being able to externally invest all available funds each day and any funds not able to be invested externally would remain in AEP Texas's bank account and earn a lower return from the bank. "Therefore, AEP Texas is earning a higher return on the total amount of excess funds because of the Utility Money Pool." Sixth and finally, Ms. Hawkins stated that the FERC also allows a utility to enter into open account advances, if funding is needed beyond its short-term debt authorization limit. "This is basically a no interest loan from the utility's parent, which is to the benefit of AEP Texas and customers."⁷²⁴

Ms. Hawkins questioned the potential breadth and detrimental effects of a "no commingling" ring-fence measure. Briefly, the Non-Consolidation Legal Opinion "may require any number of operational and shared service changes and be prohibitively expensive to obtain." She stated that AEP Texas has been managed as part of a holding company for decades and all affiliate agreements would have to be reviewed as part of obtaining a Non-Consolidation Legal Opinion. "These restrictions will have numerous consequences and costs that are not known at this time."⁷²⁵

Finally, AEP Texas argues that the Commission does not have the authority to impose ring-fencing in a rate case because nothing in PURA Chapter 36 provides for the imposition of the enumerated financial protections in the exercise of that authority.⁷²⁶ The Company argues that, while the Commission can condition a sale-transfer-merger transaction on an agreement to implement ring-fencing protections before finding a transaction to be consistent with the public

⁷²⁴ AEP Texas Ex. 43 (Hawkins Reb.) at 15-17.

⁷²⁵ AEP Texas Ex. 43 (Hawkins Reb.) at 17.

⁷²⁶ *See, e.g.*, PURA § 36.001.

interest in accordance with PURA §§ 39.262 and 39.915, that authority does not apply in this PURA Chapter 36 case..⁷²⁷

2. Commission Authority to Require Ring-Fencing in this Case

The ALJs conclude that PURA grants the Commission authority to order ring-fencing. This is the same conclusion reached by the ALJs who heard the recent CenterPoint Energy Houston Electric, LLC (*CenterPoint*) rate case that addressed these same ring-fencing issues..⁷²⁸

To date, the only Commission orders that require ring-fencing are the Oncor ring-fencing orders (*Oncor*)..⁷²⁹ Those requirements originally applied to Oncor and its relevant affiliates, and now apply to Oncor, a few other electric utilities that were part of a sale-transfer-merger transaction regarding Oncor, and relevant affiliates of each. Although Staff based its proposed ring-fencing measures in this case on those approved in the *Oncor* cases, the Commission's authority to require such measures here remains an issue of first impression. By the time the Commission considers this PFD, it may have considered and finally ruled on similar ring-fencing issues raised in *CenterPoint*. As in *CenterPoint*, there are two factual differences between this case and the *Oncor* cases. First, in the *Oncor* cases, the utilities and affiliates required to comply with the ring-fencing

⁷²⁷ AEP Texas Initial Brief at 72-73, citing *Nucor Steel-Texas v. Public Utility Comm'n of Tex*, 363 S.W.3d 871 (Tex. App.—Austin 2012, no. pet.) (“[P]rior to the enactment of PURA § 39.262(o), the Commission had no express authority to enforce stipulations filed as part of a notification of a proposed transaction under section 14.01.” And noting PURA § 39.262(o) “granted the additional authority to enforce stipulations made as part of a filing under section 14.101.”). The Company states these enactments would have been unnecessary if the Commission already possessed the power to impose and enforce such conditions under § 14.101. AEP Texas Initial Brief at 72.

⁷²⁸ Docket No. 49421, PFD at 193-99 (Sep. 16, 2019).

⁷²⁹ Staff Ex. 1 (Tietjen Dir.) at 9. See *Joint Report and Application of Oncor Electric Delivery Company LLC, Sharyland Distribution & Transmission Services, L.L.C., Sharyland Utilities, L.P., and Sempra Energy for Regulatory Approvals Under PURA §§ 14.101, 37.154, 39.262, and 39.915*, Docket No. 48929, Order (May 9, 2019); *Joint Report and Application of Oncor Electric Delivery Company LLC and Sempra Energy for Regulatory Approvals Pursuant to PURA §§ 14.101, 39.262, and 39.915*, Docket No. 47675, Order (Mar. 8, 2018); *Joint Report and Application of Oncor Electric Delivery Company LLC, Ovation Acquisition I, LLC, Ovation Acquisition II, LLC, and Shary Holdings, LLC for Regulatory Approvals Pursuant to PURA §§ 14.101, 37.154, 39.262(l)-(m), and 39.915*, Docket No. 45188, Order (Mar. 24, 2016); *Joint Report and Application of Oncor Electric Delivery Company and Texas Energy Future Holdings Limited Partnership Pursuant to PURA § 14.101*, Docket No. 34077, Order on Rehearing (Apr. 24, 2008).

committed to do so, whereas AEP Texas and its affiliates have not made any such commitment. Second, the *Oncor* cases involved Commission approval of transactions requiring such approval under statutes discussed below, whereas this is a rate case. AEP Texas cites both differences arguing that the Commission lacks authority to order ring-fencing in this PURA Chapter 36 case.

Staff and TIEC rely on PURA §§ 11.002 and 14.001 to argue that the Commission has authority to require the utility to implement protective ring-fencing mechanisms when reviewing a utility's financial risk in setting just and reasonable rates in a PURA Chapter 36 rate case. As noted above, AEP Texas argues that PURA §§ 14.101, 39.262, and 39.915 created Commission authority to enforce ring-fencing for the specific purpose of reviewing and approving of certain transactions, such as mergers. AEP Texas contends that the Commission has no general implied power to enforce ring-fencing because, if it did, that specific grant of authority over transactions such as mergers would be redundant and without purpose.

The ALJs agree with AEP Texas that PURA grants the Commission express authority to interpret and enforce conditions proposed by a party to the transaction in connection with a PURA §§ 39.262 or 39.915 (or § 14.101) transaction. The ALJs find unconvincing AEP Texas's arguments that the Commission lacks implied authority to impose ring-fencing, or that its authority in a rate case excludes its authority under PURA provisions that are not in PURA Chapter 36.⁷³⁰ The Company's limited interpretation does not square with PURA as a whole. AEP Texas essentially suggests that the Commission could not require the utility to use ring-fencing if the utility were actually in peril due to actions by its parent: (1) by order in the rate case; or (2) at all, absent both a filing seeking Commission approval of a PURA §§ 39.262 or 39.915 transaction, and a stipulation, representation, or commitment by a party to the transaction agreeing to the ring-

⁷³⁰ PURA does not state the Commission may exercise only powers mentioned in chapter 36 in a rate case. Implying such a limitation would be contrary to PURA §§ 11.002 and 14.001. *See also* Tex. Gov't Code ch. 311 (Code Construction Act), § 311.021(1) ("In enacting a statute, it is presumed that... the entire statute is intended to be effective").

fencing. Such a narrow view of Commission authority would defeat legislative purposes to protect the public and be contrary to applicable rules of statutory construction..⁷³¹

The ALJs agree with Staff and TIEC that PURA grants the Commission broad authority under PURA §§ 11.002 and 14.101. Specific Commission powers and duties incorporated in these two provisions include:

- § 14.003: “The commission may: (1) require a public utility to report to the commission information relating to: ... (B) a transaction between the utility and an affiliate inside or outside this state, to the extent that the transaction is subject to the commission’s jurisdiction; ... (5) require the filing of a copy of: (A) a contract or arrangement between a public utility and an affiliate;...”
- § 14.154(a): “The commission has jurisdiction over an affiliate that has a transaction with a public utility under the commission’s jurisdiction to the extent of access to a record of the affiliate relating to the transaction, including a record of joint or general expenses, any portion of which may be applicable to the transaction.”
- § 14.201: “A regulatory authority may inquire into the management and affairs of each public utility and shall keep itself informed as to the manner and method in which each public utility is managed and its affairs are conducted.”
- § 36.003(a): “The regulatory authority shall ensure that each rate an electric utility or two or more electric utilities jointly make, demand, or receive is just and reasonable.”
- § 39.157(d), requiring the Commission to adopt rules ensuring that:
 - (11) a utility does not subsidize the business activities of an affiliate with revenues from a regulated service; ...
 - (13) a utility and its affiliates keep separate books and records and the commission may review records relating to a transaction between a utility and an affiliate;

⁷³¹ See, e.g., PURA § 11.008 (“This title shall be construed liberally to promote the effectiveness and efficiency of regulation of public utilities to the extent that this construction preserves the validity of this title and its provisions”); Tex. Gov’t Code § 311.021(5) (“In enacting a statute, it is presumed that... public interest is favored over any private interest”).

- (14) assets transferred or services provided between a utility and an affiliate... are priced at a level that is fair and reasonable to the customers of the utility and reflects the market value of the assets or services or the utility's fully allocated cost to provide those assets or services...[and]
- (17) a utility does not allow an affiliate to obtain credit under an arrangement that would include a specific pledge of assets in the rate base of the utility or a pledge of cash reasonably necessary for utility operations.⁷³²

Based on these PURA provisions, the ALJs conclude the Commission has authority in an electric utility's rate case, with or without the utility's agreement, to impose on the utility ring-fencing requirements that the evidence shows are necessary and convenient to the Commission's exercise of its express powers and duties, including those set forth above.

Some of Staff's ring-fencing proposals, if adopted, may require AEP or AEP Texas or other AEP affiliates to take or refrain from certain actions. Another issue is thus the Commission's authority to impose such requirements on a utility's affiliates in a case like this, which does not involve a PURA § 14.101, 39.262(l), or 39.915 transaction or ring-fencing to which the utility and affiliate have agreed. Except for matters not pertinent here,⁷³³ most relevant PURA provisions refer to electric utilities, not their affiliates. Exceptions (quoted above) include PURA §§ 14.003, 14.154(a), and 39.157(d)(11), (13), (14), and (17). Commission rules implementing those statutes, 16 TAC §§ 25.84 and 25.272, do not state that they apply to electric utility affiliates; they state that they apply to electric utilities "and transactions or activities between electric utilities and their affiliates."⁷³⁴ The rules define "transaction" broadly as "[a]ny interaction between a utility and its

⁷³² The Commission restated these four § 39.157 provisions in its rule. See 16 TAC § 25.272(d)(2)(6), (d)(7)(b), (e)(1), (e)(1)(B)-(C). Although other parts of PURA § 39.157 and 16 TAC § 25.272 refer to "competitive affiliates," these four provisions use the broader term "affiliates." The ring-fencing issue here relates to "affiliates" of AEP Texas as that term is defined in PURA § 11.003(2) and 16 TAC § 25.5(3).

⁷³³ The ring-fencing issue here does not involve Commission authority over: (1) affiliate expenses for which the utility seeks rate recovery; and (2) a utility's competitive affiliates. "Competitive affiliate" is defined as "an affiliate of a utility that provides services or sells products in a competitive energy-related market in this state...." PURA § 39.157(i)(1) and 16 TAC § 25.5(15).

⁷³⁴ 16 TAC §§ 25.84(b)(1), 25.272(b)(1).

affiliate in which a service, good, asset, product, property, right, or other item is transferred or received by either a utility or its affiliate.”⁷³⁵ In discussing its authority to adopt those rules, the Commission stated its interpretation of PURA §§ 14.003, 14.154, and 39.157 as follows:

Section 14.003 grants the commission the authority to require submission of information by the utility regarding its affiliate activities.... Section 14.154 grants the commission *limited authority over the utility’s affiliates, with respect to their transactions with the utility*.... Section 39.157 grants the commission authority to take actions... to adopt rules and enforcement procedures *to govern transactions or activities between utilities and their affiliates*.⁷³⁶

The Commission also emphasized that “[n]o subsidization of affiliates from utility services is allowed in these rules,” noting that § 25.272(e)(1) (regarding transactions with all affiliates) is consistent with the statutory language but disagreed “with the utilities’ implication that the commission could not impose additional requirements relating to credit support,” and clarified that § 25.272(e)(1) “applies to all assets, rather than ‘jurisdictional capital assets.’”⁷³⁷

Based on the law discussed above, the ALJs conclude that, under the facts of this case, the Commission has authority to order AEP Texas to implement specific ring-fencing measures. Although the Commission’s authority over affiliates is limited, it includes authority to require access to the information to which the Commission has a statutory right and to order ring-fencing relating to transactions between AEP Texas and an affiliate under the rules’ broad definition of “transaction” (quoted above). The Commission also has powers to enforce a violation of a Commission order.⁷³⁸

⁷³⁵ 16 TAC §§ 25.84(c), 25.272(c)(7).

⁷³⁶ Project No. 20936, *Code of Conduct for Electric Utilities pursuant to PURA Section 39.157(d)*, Order Adopting an Amendment to § 25.84 and New § 25.272 and § 25.273 as Approved at the November 18, 1999 Open Meeting and Submitted to the Secretary of State (Nov. 23, 1999) at 81-82 (emphasis added).

⁷³⁷ Project No. 20936, Order at 2, 37-38 (Nov. 23, 1999).

⁷³⁸ See PURA § 11.003(14) and ch. 15, subch. B.

3. Need for Utilities with Affiliates to Have Adequate Ring-Fencing

Staff witness Tietjen testified that financial instability or weakness in a utility's parent and other affiliates could affect the utility adversely and that adequate ring-fencing is necessary to address those risks:

Given the number of subsidiaries...that are part of the overall AEP organization, to the degree that there are aspects of operational and financial intermingling or interdependency among the various entities, the effects of financial instability or weakness in one entity could affect not only AEP as the parent company, but other subsidiaries as well. In an extreme case, an event that causes severe financial distress for AEP could lead to its bankruptcy—a situation, that, absent the presence of protective measures, could impact subsidiaries like AEP Texas dramatically and drag them along into the bankruptcy process..⁷³⁹

The ALJs agree in part with Mr. Tietjen's concern: the fact that AEP Texas has affiliates (and a parent) is a factor in considering whether ring-fencing measures should be imposed. The ALJs also note, however, that Mr. Tietjen acknowledges a potential "extreme case" in which AEP enters bankruptcy, which could (not will) drag AEP Texas into the bankruptcy process. The ALJs also understand that financial weakness in an affiliate could affect AEP Texas, although no party presented detailed testimony, beyond speculation, as to how that result would happen.

4. ALJs' Analysis and Recommendations

The ALJs recommend that the Commission order AEP Texas to continue to abide by its current voluntary ring-fencing measures, and adopt, in whole or in part, six of the 13 additional measures proposed by Staff.

The ALJs realize that this recommendation is different from the ring-fencing recommendations made by the ALJ panel in the recent *CenterPoint* PFD. The primary reasons for

⁷³⁹ Staff Ex. 1 (Tietjen Dir.) at 7-8.

this difference are that AEP Texas does not face the same potential financial issues that were addressed in *CenterPoint*, and AEP Texas's witnesses presented substantial specific testimony explaining why some of the additional 13 measures would create problems and be detrimental to the Company's financing practices without providing overriding benefits or necessary protections.

Unlike *CenterPoint*, AEP Texas has not had a Vectren Corporation (Vectren)-type of acquisition within its corporate family that could adversely affect the Company's financial stability. In the *CenterPoint* PFD, the ALJs noted "CenterPoint's credit rating was recently downgraded in February 2019 because of 'the risks associated' with CenterPoint's parent company, including its parent's acquisition of Vectren, not because of the risks associated with CenterPoint, as CenterPoint claims."⁷⁴⁰ The *CenterPoint* PFD includes a significant discussion of the effects Vectren had on CenterPoint's parent's (CNP's) financial assessments.⁷⁴¹ After recounting the ratings agencies' reaction to the Vectren acquisition, the *CenterPoint* PFD focuses on the risks created by the Vectren acquisition:

Moody's downgraded CNP because of the Vectren acquisition. Moody's and Fitch currently rate CNP two notches below CenterPoint. The fact that S&P uses a consolidated rating methodology but Fitch and Moody's rate CenterPoint mainly on its own financial condition does not mean CenterPoint's affiliates do not pose actual risks that warrant the Commission requiring a stronger ring fence.

CNP has been depending on net income from CenterPoint. CNP's net income from other business operations has been negative. CNP undertook a disproportionately debt-financed acquisition of Vectren, including assuming its debt, which led to a rating downgrade of CNP and CenterPoint. CenterPoint's financial strength could be used to support affiliates in financial distress or finance their higher-risk business ventures. The risk to CenterPoint's customers is especially high if its parent were to enter bankruptcy. Although the Commission sets CenterPoint's rates, the regulatory process takes time. Without a strong enough

⁷⁴⁰ Docket No. 49421, PFD at 186 (Sep. 16, 2019). The PFD describes Vectren as follows: "Vectren, which CenterPoint acquired in February 2019 and which includes vertically integrated electric utility operations in Indiana and Ohio. Vectren also owns unregulated infrastructure/construction and energy businesses that make up about 25% of Vectren's earnings." *Id.* at 201 (footnote omitted).

⁷⁴¹ *Id.* at 202-03.

ring fence, CenterPoint's financial condition could be weakened to the point of requiring higher rates to provide reliable service..⁷⁴²

In short, AEP Texas and AEP have not had a Vectren-type acquisition in their corporate structure and, as such, the AEP companies' current financial situation is not burdened with an acquisition that caused a ratings downgrade. The ALJs realize that AEP could acquire a Vectren-type entity in the future, but considering that AEP is the parent over numerous regulated electric utilities, AEP's potential future acquisitions would likely be tempered with an eye toward the CNP/CenterPoint situation. For these reasons, the ALJs conclude that AEP Texas is not in as financially risky a situation as may be facing CenterPoint and this is part of the reason for not recommending imposition of a number of the new financial protections addressed in Mr. Tietjen's testimony.

Based primarily on Ms. Hawkin's and Mr. Fetter's testimony, Mr. Tietjen's comments that AEP's corporate structure may not be as likely as that of the parents of some other Texas utility companies to experience financial stress that could flow through to its subsidiaries, and because AEP does not have a recent subsidiary acquisition that led to a ratings downgrade, the ALJs conclude that the ring-fencing measures that deal with dividends, intra-company lending, and the Non-Consolidation Legal Opinion are not necessary in this case at this time. Similarly, as with the *CenterPoint* PFD, the ALJs do not recommend adopting measures that would preclude AEP Texas from making certain arguments in future rate cases. As the *CenterPoint* ALJs noted, the Commission may accept or reject such arguments after considering the evidence and briefing in those cases..⁷⁴³

As set out below, the ALJs recommend that the Commission order the four ring-fencing measures to which AEP Texas already adheres. There is some overlap between these four self-

⁷⁴² *Id.* at 214.

⁷⁴³ Docket No. 49421, PFD at 218 (Sep. 16, 2019).

imposed measures and the new measures recommended by Staff, but to the extent there is an overlap, these four would control over the specified actions:

- AEP Texas must not share its credit facility with any unregulated affiliates;
- AEP Texas debt must not be secured by non-AEP Texas assets;
- AEP Texas assets must not secure the debt of AEP or its non-AEP Texas affiliates; and
- AEP Texas assets must not be pledged for any other entity.

Based on the foregoing, the ALJs also recommend that the following six measures proposed by Staff should be adopted. The first bulleted item below has been truncated to delete references to how AEP Texas must handle dividends in certain situations. The other bullets are unchanged from those proposed by Staff, unless indicated otherwise. The ALJs recommend these six measures because they do not appear to directly implicate issues involving dividends; intra-AEP lending; the Non-Consolidation Legal Opinion; or Commission determinations on what types of debt and equity would be in AEP Texas's debt-to-equity ratio:

Additional Financial Protections Proposed by Staff:

- AEP Credit Ratings and Dividends. AEP Texas must work to ensure that its credit ratings at S&P and Fitch remain at or above AEP Texas's current credit ratings..⁷⁴⁴
- Stand-Alone Credit Rating. Except as may be otherwise ordered by the Commission, AEP Texas must take the actions necessary to ensure the existence of a AEP Texas stand-alone credit rating.
- AEP Texas's Credit. AEP Texas must not hold out its credit as being available to pay the debt of any AEP affiliates.

⁷⁴⁴ This is the first clause in the second bullet of Staff's list of 13 proposed new measures. Additional language that Staff had proposed in this measure that dealt with dividend restrictions has been deleted.

- No Commingling of Assets. AEP Texas must not commingle its assets with those of other AEP affiliates.
- No Pledging of Assets Commitment. AEP Texas must not pledge its assets with respect to, or guarantee, any debt or obligation of AEP affiliates.
- Affiliate Asset Transfer Commitment. AEP Texas must not transfer any material assets or facilities to any affiliates, other than a transfer that is on an arm's-length basis consistent with the Commission's affiliate standards applicable to AEP Texas, ~~regardless of whether such affiliate standards would apply to the particular transaction.~~⁷⁴⁵

For clarity, the following are seven and one-half new proposed measures proposed by Staff that the ALJs recommend the Commission *not* adopt:

Additional Financial Protections Proposed by Staff:

- Dividend Restriction Commitment. AEP Texas must limit the payment of dividends by AEP Texas to an amount not to exceed AEP Texas's net income (as determined in accordance with generally accepted accounting principles).
- AEP Credit Ratings and Dividends. . . . and if AEP Texas's credit rating at either of these ratings agencies falls below BBB+ [footnote omitted] (or its equivalent) for AEP Texas's senior secured debt, then AEP Texas must suspend payment of dividends or other distributions, except for contractual tax payments, until otherwise allowed by the Commission. AEP Texas must notify the Commission if its credit issuer rating or corporate rating as rated by either of the major rating agencies falls below investment-grade level.
- Debt-to-Equity Ratio Commitment. AEP Texas's debt must be limited so that its debt-to-equity ratio is at or below the debt-to-equity ratio established from time to time by the Commission for ratemaking purposes in AEP Texas's rate proceedings. The Commission has authority to determine what types of debt and equity are included in a utility's debt-to-equity ratio. AEP Texas must not make any payment of dividends or other distributions, except for contractual tax payments, where such dividends or other distributions would cause AEP Texas to be out of compliance with the Commission-approved debt-to-equity ratio.

⁷⁴⁵ This is the ninth bullet in Staff's list of 13 proposed new measures. The last clause in this bullet has been struck, as was proposed by the ALJs in the *CenterPoint* PFD because the strike-through language appears to impose requirements at odds with applicable affiliate standards. See Docket No. 49421, PFD at 218 (Sep. 16, 2019).

Additionally, neither AEP nor any of its affiliates may issue stock or ownership interest that supersede the foregoing obligations of AEP Texas.

- ROE Commitment. If AEP Texas's issuer credit rating is not maintained as investment grade by S&P and Moody's, AEP Texas must not use its below-investment-grade ratings to justify an argument in favor of a higher regulatory ROE.
- No Inter-Company Lending and Borrowing Commitment. AEP Texas must not lend money to or borrow money from AEP affiliates.
- No Debt Disproportionally Dependent on AEP Texas. Without prior approval of the Commission, neither AEP nor any affiliate of AEP (excluding AEP Texas) may incur, guaranty, or pledge assets in respect of any incremental new debt that is dependent on: (1) the revenues of AEP Texas in more than a proportionate degree than the other revenues of AEP; or (2) the stock of AEP Texas.
- Non-Consolidation Legal Opinion. AEP must obtain a non-consolidation legal opinion that provides that, in the event of a bankruptcy of AEP or any of its affiliates, a bankruptcy court will not consolidate the assets and liabilities of AEP Texas with AEP or any of its affiliates.
- No Bankruptcy Cost Commitment. AEP Texas must not seek to recover any costs associated with a bankruptcy of AEP or any of its affiliates.

VI. OPERATING AND MAINTENANCE EXPENSES [PO ISSUES 4, 5, 25, 26, 27, 31, 32, 34, 35, 39, 41, 44, 45]

A. Transmission and Distribution O&M Expenses [PO Issue 25]

Cities and STEC argue that because AEP Texas's T&D O&M expenses are unusually high in the test year, the Commission should adjust them to conform more closely to preceding years. While they both challenge the marked increase in test year O&M expenses, they differ in their recommended adjustments. STEC, characterizing the test year as an outlier, averages the three years preceding the test year,⁷⁴⁶ whereas Cities averages the two preceding years and the test year itself, to account for some increase. STEC challenges AEP Texas's overall T&D O&M expenses,

⁷⁴⁶ STEC Ex. 1 (Allen Dir.) at 9.